

# ■ Regional Analysis

The remainder of this article will take a regional view of short-term prospects for the world economy. The survey will give an overview of the world, but it will emphasize the economies that are the most important export markets for U.S. manufactured goods. The following overview will include an assessment of underlying trends, major risk factors, and specific problems and opportunities. The 20 countries that comprise the destination for the majority of manufactured goods exports of the United States are listed in Table 2 and 3.

## ■ NORTH AMERICAN FREE TRADE AGREEMENT

NAFTA members Canada and Mexico are the two most important trading partners of the United States. The United States ships more than a third of its manufactured goods exports to the two countries and receives almost 30 percent of its total manufactured goods imports from them. U.S. manufactured goods exports to both countries dropped in 2001 (by 8.6 percent to Canada, and by 9.8 percent to Mexico). The fall in exports to the NAFTA partners was part of an overall decline in U.S. manufactured goods exports in 2001, as well as part of the global drop in world trade. Through the first nine months of 2002, total U.S. merchandise exports to Canada and Mexico continued on a downward trend in comparison with the same period in 2001.

Canada has been one of the better-performing industrial economies in the current business cycle. Although growth did slow to 1.5 percent in 2001, Canada's economy avoided the recession that hit the United States. In 2002, the economy picked up smartly and should finish the year with approximately 3.4-percent

growth, the best showing among the Group of Seven. Canada avoided much of the negative fallout from the equity market collapse, compared with the United States. Additionally, since its economy is much less dependent on information and technology sectors, Canada had much less of a capital investment overhang. Canada has also benefited from higher energy prices. Investment spending in Canada has begun to rebound. Employment has been growing, consumer and business confidence remain high, and capacity utilization is running at high levels. Inflation has been edging up, and the Bank of Canada tightened monetary policy in the spring and summer. In 2003, growth is projected to be slightly lower, although near the long-term potential rate of growth in Canada. Uncertainty in the international arena, an expected slowdown in housing construction, and slower growth in exports are behind the forecast for slightly lower growth. In addition, there was a large advance in inventory growth in the second quarter that will likely slow.

Mexico is the second-largest market for U.S. manufactured goods exports and the third-largest source of U.S. manufactured goods imports, just behind Japan. In 2001, U.S. imports of Mexican manufactured goods constituted 91 percent of U.S. imports of manufactured goods from Japan. Five years earlier, U.S. imports of manufactured goods from Japan were nearly twice as large as manufactured goods imports from Mexico. The sharp narrowing of the gap in this facet of U.S. trade with Japan and Mexico reflects two important trends that have been shaping U.S. and world trade in recent years. First, the growth in manufactured imports from Mexico reflects the fact that since the advent of the North American Free Trade Agreement, many U.S. and other foreign

manufacturing operations have moved to Mexico. However, recently Mexico has been losing manufacturing assembly operations to China and countries in Central America.

The Mexican economy began recovering from the 2001 recession in the spring of 2002. An increase in exports to the United States, as well as an increase in investment spending, was behind this growth. Government fiscal and monetary policies were restrictive during this period. Budget cuts were made in response to falling tax revenues. Interest rates were increased in October to support the peso, which fell sharply in 2002. The Mexican economy is highly dependent on the United States. The United States consumes more than 70 percent of the country's exports. The outlook for Mexican growth in 2003 depends greatly on the continued recovery in the United States. Foreign investment in Mexico remained relatively strong in 2002, since the country avoided the economic fallout that hit other Latin American nations as a result of the collapse of Argentina's economy. Mexico is highly dependent on external financing. Given this dependency, financial market risk continues to be an important uncertainty in the country's economic future, particularly if tax, electricity, and other reforms stall. The Mexican economy is expected to grow only 1.5 percent in 2002, but growth is expected to accelerate to approximately 3.3 percent in 2003, and slightly higher in 2004.

## ■ WESTERN EUROPE

Ten Western European economies are among the top 20 markets for U.S. manufactured goods (see Table 2 and 3). The United States ships approximately 25 percent of its manufactured goods exports to Western Europe. Over the last five years, exports to this market have grown slightly faster than

U.S. manufactured goods exports to the world (see Table 3). Four countries—the United Kingdom, Germany, France, and the Netherlands—are in the top eight destinations for U.S. manufactured goods, and sales growth to each of these four was above average in the 1996–2001 period. Among the remaining six European countries in the top 20 list, exports to Ireland should be singled out, because of the very rapid export growth in the last five years. The value of manufactured exports to Ireland more than doubled in the 1996–2001 period, and the average annual growth of exports during these years (15.2 percent) is the fastest in the list of 20. The surge of exports was a reflection of Ireland's becoming an assembly and export base for multinational companies doing business in Europe. With its well-educated, English-speaking workforce and relatively low labor costs, Ireland was seen as an ideal location. Foreign

direct investment poured into the country. Nevertheless, with the burst of the high-tech bubble, the boom has ended. Additionally, Ireland is now facing competition from several lower-cost countries in Central and Eastern Europe that will be joining the European Union in mid-2004.

Whether U.S. exports to Western Europe will continue to grow at the same pace over the next five years appears more doubtful. Except for exports to Germany, shipments to the other European countries in the list of top 20 markets fell in 2001, along with exports to most markets. In the first nine months of 2002, exports to Western European markets fell at a faster rate than the decline in U.S. exports to the world.

The problem is that a brief but weak economic recovery that began late in 2001 appears to have run its course

and a new slowdown is in progress. Weak consumer spending, stagnant investment, and softening export orders have led to a downgrade in the region's growth outlook. The most recent data indicate that the German economy registered minimal growth in the third quarter of 2002, as did the economies of Italy, the Netherlands, and Switzerland. The United Kingdom, Spain, Sweden, and France have fared better. The brief and shallow recovery that now is losing momentum was led by the export sector. Domestic demand, except for generally expansive fiscal policy, has been insufficient. Consumer spending, inventory rebuilding, and stronger investment are expected to provide the stimulus for faster growth in 2003.

#### ASIA

For several years, the majority of U.S. foreign trade has been with Asia rather than with markets in Europe.

**TABLE 2. GROWTH IN THE TOP 20 MARKETS FOR U.S. MANUFACTURED GOODS**

(Annual percentage change in real output, history, and forecast.)

Partner	1999	2000	2001	2002 (Estimate)	2003 (Forecast)	Annual Growth 1996–2001
1 Canada	5.4	4.5	1.5	3.4	3.2	3.9
2 Mexico	3.6	6.6	-0.3	1.5	3.3	4.3
3 Japan	0.7	2.8	0.3	-0.5	0.7	0.7
4 United Kingdom	2.4	3.1	1.9	1.6	2.5	2.7
5 Germany	2.0	2.9	0.6	0.3	1.1	1.8
6 France	3.2	4.2	1.8	1.0	1.8	2.9
7 South Korea	10.9	9.3	3.0	6.1	5.8	4.1
8 The Netherlands	4.0	3.4	1.2	0.3	1.4	3.4
9 Singapore	6.9	10.3	-2.0	3.6	4.2	4.6
10 Taiwan	5.4	5.9	-1.9	3.3	4.0	4.1
11 China	7.1	8.0	7.3	7.5	7.2	7.8
12 Brazil	0.8	4.4	1.5	1.5	3.0	2.0
13 Hong Kong	3.0	10.4	0.2	1.5	3.4	2.5
14 Belgium	3.0	4.0	1.0	0.6	1.7	2.8
15 Australia	4.8	3.1	2.6	3.0	3.0	3.9
16 Switzerland	1.6	3.0	0.9	0.0	1.2	1.9
17 Malaysia	6.1	8.3	0.5	3.5	5.3	2.8
18 Italy	1.6	2.9	1.8	0.4	1.5	2.0
19 Ireland	10.9	11.5	5.9	3.8	5.3	9.5
20 Israel	2.6	7.4	-0.9	-1.5	1.8	3.0
<b>Weighted Total</b>	<b>3.8</b>	<b>5.1</b>	<b>2.7</b>	<b>2.8</b>	<b>3.4</b>	<b>3.7</b>

Source: Historical data from the IMF; forecast data from the ITA, U.S. Department of Commerce.

In 2001, slightly more than 25 percent of U.S. manufactured goods exports were sent to Asia, and a larger share of U.S. manufactured imports, 43 percent, was from the region. Eight of the top 20 export markets for U.S. manufactured goods are in the region (see Table 2 and 3). Japan, South Korea, Singapore, and Taiwan are in the top 10, with China ranked at number 11. Despite the importance of this trade to the United States, over the last five years the performance of U.S. manufactured goods exports to the region has definitely fallen short of the average growth of exports to the world. Two major and well-known economic shocks account for the sluggish growth. First, following the Asian financial crisis in 1997, many countries in the region experienced rapid capital

flight and curtailed imports to reduce current account imbalances. Second, the recent bust in telecommunications and information technology sectors significantly affected U.S. trade with several Southeast Asian economies that specialize in producing goods for these sectors.

The recent performance of Asian economies and the outlook for 2003 present a mixed picture. Among the developed industrial countries in the region (including Australia and New Zealand), Japan has undoubtedly been the laggard. After very slow growth in the first quarter of 2002, the Japanese economy recorded good growth in the spring and summer months, including a modest increase in exports. But the midyear deceleration of the U.S.

economy (and a stronger yen) cut short the modest rebound in exports. Continuing weak domestic demand is expected to result in negative economic growth for 2002 as a whole. The outlook for 2003 is that the Japanese economy will grow very slowly. In the last quarter, investment spending fell. Consumer confidence is abysmal, economic reform has stalled, deflation continues unabated, and the government seems unable to formulate new initiatives to propel economic growth. The major problem continues to be the massive amount of bad, non-performing loans that are strangling the banking sector.

The other advanced industrial economies in Asia, Australia and New Zealand, have had much better

**TABLE 3. U.S. EXPORTS OF MANUFACTURED GOODS TO LEADING MARKETS**

(millions of U.S. dollars)					Share of	Share of	Annual
Partner	1996	1999	2000	2001	World in 2001	Top 20 in 2001	Growth 1996–2001
World	522,660	611,781	689,524	641,885	100.0%		4.2%
European Union	110,025	138,917	151,676	146,210	22.8%		5.9%
NAFTA	168,730	227,402	259,891	236,368	36.8%		7.0%
South America	31,392	31,503	33,975	33,762	5.3%		1.5%
Asia	162,859	159,130	184,068	165,602	25.8%		0.3%
<b>Top 20 Markets</b>	<b>427,270</b>	<b>512,460</b>	<b>585,762</b>	<b>539,645</b>	<b>84.1%</b>	<b>100.0%</b>	<b>4.8%</b>
1 Canada	119,952	149,585	160,662	146,906	22.9%	27.2%	4.1%
2 Mexico	48,778	77,817	99,229	89,463	13.9%	16.6%	12.9%
3 Japan	46,969	42,205	48,972	43,622	6.8%	8.1%	-1.5%
4 United Kingdom	28,658	36,237	39,544	38,637	6.0%	7.2%	6.2%
5 Germany	21,177	25,081	27,364	28,288	4.4%	5.2%	6.0%
6 France	13,199	17,965	19,349	18,998	3.0%	3.5%	7.6%
7 South Korea	20,413	18,825	23,444	18,096	2.8%	3.4%	-2.4%
8 The Netherlands	13,415	17,097	19,563	17,210	2.7%	3.2%	5.1%
9 Singapore	15,955	15,606	17,133	16,890	2.6%	3.1%	1.1%
10 Taiwan	14,404	16,511	21,668	15,602	2.4%	2.9%	1.6%
11 China	9,131	11,406	13,128	15,465	2.4%	2.9%	11.1%
12 Brazil	11,279	12,550	14,528	15,170	2.4%	2.8%	6.1%
13 Hong Kong	11,781	11,093	12,966	12,512	1.9%	2.3%	1.2%
14 Belgium	9,546	10,655	12,318	12,002	1.9%	2.2%	4.7%
15 Australia	11,347	11,203	11,841	10,371	1.6%	1.9%	-1.8%
16 Switzerland	8,155	8,153	9,716	9,597	1.5%	1.8%	3.3%
17 Malaysia	7,747	8,681	10,581	8,836	1.4%	1.6%	2.7%
18 Italy	6,820	8,690	9,398	8,336	1.3%	1.5%	4.1%
19 Ireland	3,377	6,089	7,354	6,837	1.1%	1.3%	15.2%
20 Israel	5,167	7,011	7,004	6,807	1.1%	1.3%	5.7%

Source: Census Bureau, U.S. Department of Commerce.

growth. Both economies slowed in late 1999, but they have rebounded since. Australia's economy was on track to grow by around 4 percent in 2002. However, a severe drought, the worst in 100 years, has seriously damaged the country's agricultural sector, and the outlook for growth in 2002 and 2003 is 3-percent growth. New Zealand is expected to register 3-percent growth in 2002, and to grow at a slightly slower rate in 2003.

Among emerging markets, the two Asian giants, China and India, continue to exhibit strong growth. The influx of foreign direct investment (FDI) associated with China's entry into the World Trade Organization has resulted in a new round of export-led growth in that country. Much of the new FDI represents relocation of manufacturing operations to China from other countries, mainly the United States, Japan, and Europe. This geographic restructuring of manufacturing has accounted for as much as 40 percent of China's export growth this year, according to Andy Xie, an analyst at Morgan Stanley. In fact, Mr. Xie estimates that even in a flat-growth world economy, China's exports would grow approximately 7 percent because of the relocation activities. China has also relied on increased government borrowing for massive spending programs to propel its rapid growth. India, while not known as a destination for much FDI, has seen its share increasing in recent years, particularly in the south. Much of this investment has been in telecommunications and information technology industries. India and China are expected to record 2002 growth of 5 percent and 7.5 percent, respectively. In 2003, China's growth is expected to slow slightly, while India should do even better than last year.

Except for South Korea, the newly industrialized economies (the NIEs—South Korea, Taiwan, Singapore, and Hong Kong) of East Asia suffered a very bad year in 2001, due



to the high-tech bust. In early 2002, the four economies in this group rebounded some, but a slowdown in export growth to the sputtering U.S. economy has resulted in an end to that early expansion. Among this group, only South Korea was able to generate strong domestic demand through an expansion of consumer credit. South Korea is also less reliant on information technology exports, a factor that will continue to constrain growth in the economies of Taiwan, Singapore, and Hong Kong. All four of the NIEs are among the top 20 export destinations for U.S. manufactured goods.

#### ASSOCIATION OF SOUTHEAST ASIAN NATIONS

The ASEAN countries performed much better in 2001 than in the years immediately following the 1997 Asian crisis. These economies continue to make steady progress in economic restructuring. These countries' political situations have become more stable, but the recent terrorist bomb-

ing in Indonesia has introduced a new level of uncertainty in the region. As with the NIEs, export growth in the second half of 2002 has slowed, and expected growth for this group of countries has been reduced. Faster growth in 2003 is predicted based on the assumption of stronger world and U.S. economies. The longer-term prospect for the ASEAN group is problematic, because FDI in these countries has fallen (as multinationals have shifted their offshore production to China). Only Thailand has had notable success in switching to domestic sources of demand for its growth. FDI into Malaysia meanwhile has fallen. Malaysia is one of the Southeast Asian economies heavily dependent on information technology exports. Not only have Malaysian exports suffered because of the IT slump, but also IT investment is increasingly heading to China. Malaysia's economy has rebounded in 2002 from nearly stagnant growth in 2001. Slightly faster growth is expected in 2003, but the





era of near double-digit growth for the country appears to be over.

#### **LATIN AMERICA**

Only Brazil, among the countries of Central, South America, and the Caribbean, is among the top 20 markets for manufactured goods. Four additional countries, Venezuela, Argentina, the Dominican Republic, and Colombia are among the top 30 markets. U.S. manufactured goods exports to Brazil, the Dominican Republic, and Venezuela grew at healthy rates in the last five years, but exports to Argentina and Colombia declined during this period. The outlook for U.S. export growth to the region is somewhat pessimistic in the near term, due to weak economies in the region.

The economies of Latin America grew by less than 1 percent in 2001, and they are expected to contract by a similar amount in 2002. A modest recovery to 3-percent growth is forecast for 2003, but the forecast for this region is very uncertain given economic and political turmoil in many areas. In Brazil, the election of the left-of-center government of Luiz Lula da Silva and the sharp fall in the value of the country's currency in the weeks leading up to the election have put further strains on the already weak economy. The 30-percent decline in the value of the real has helped Brazilian exports, but the decline in the value of the currency has fed inflation, which is approaching 10 percent. An important test of the new administration will be how

it addresses the challenge of inflation. Argentina recently defaulted on its financial obligations to the World Bank, while negotiations between the country and the International Monetary Fund continue to drag along. In early December, the government lifted restrictions on the amounts of pesos that people had been allowed to withdraw from their savings and checking accounts. This move is one that should help the country in its negotiations with the IMF as well as provide the economy with much needed funds. There are some signs that economic activity is beginning to revive after five years of recession. Industrial production edged up, and the collapse of the peso has made the country's exports competitive again. An expected rebound in the economy where 25 percent of the labor force is unemployed is an important reason for expecting an increase of the growth rate in the region in 2003.

The region's problems, together with a general decline of investment into emerging markets in the wake of the global slowdown, put the outlook for a rebound to 3 percent growth in 2003 at risk. The direction of Brazil's economy, which accounts for around 40 percent of the region's output, is a key factor behind whether or not economic recovery proceeds.

#### **THE MIDDLE EAST**

In the region, only Israel ranks among the top 20 export markets for U.S. manufactured goods, although in the recent past Saudi Arabia has also been in this group. Saudi Arabia was the 22nd-most important market for manufactured goods in 2001. Turkey and Egypt are also very important markets for U.S. agricultural products.

Owing to the tensions associated with the possibility of war in Iraq, no region is under as dense a cloud of uncertainty as is the Middle East. Aside from Turkey, recovering from last year's economic crisis, most other countries in the region will post lower growth

in 2002 than in the previous year. Egypt's economy was hurt by a sharp fall in tourism following the events of September 11, 2001. Its industry has begun to recover but would be hurt by increasing tensions over the possibility of military action in the region. Israel's economy has experienced the worst performance in the region this year largely because of security concerns and political unrest in the West Bank and Gaza. The depression in the world IT industry has also adversely affected the country. A modest recovery of growth to around 2 percent is forecast for 2003, assuming political tensions subside.

#### AFRICA

In Africa, economic growth for 2002 is expected to come in at a slightly lower rate than in 2001. The 2003 forecast is for growth to accelerate to around 4 percent. Several countries in the region, such as Angola, Chad, and Mozambique, have recorded respectable rates of growth in recent years. Unfortunately, sluggish growth in the continent's largest economies—Nigeria, South Africa, Algeria, and Libya—has lowered the overall rate of growth for the region. As noted, growth for the region is forecast to accelerate to 4 percent in 2003, but the continent faces several serious problems. These include the continuing economic crisis in Zimbabwe, a severe threat of massive famine in Zimbabwe as well as in several other countries in the area, continuing political unrest in the Democratic Republic of Congo, and the ongoing revolt in the Ivory Coast.

#### CENTRAL AND EASTERN EUROPE AND THE COMMONWEALTH OF INDEPENDENT STATES

The economies of Central and Eastern Europe and the Commonwealth of Independent States (CIS) experienced fairly solid growth in 2001, except for Poland. In the case of Poland, soft markets in the European Union and the United States have cut export growth, while large grain harvests have pushed down food prices. Consumer demand

is weak, and unemployment growing. A slow recovery is expected in 2003. As a group, the transition economies of the region grew by 5 percent. In 2003, growth is forecast to be at a slightly lower rate. Healthy rates of growth in Russia and Ukraine, the giants of the CIS, have helped to bolster growth in the CIS region. No country in this group is a major market for U.S. manufactured goods. As these economies have made the transition from central planning to markets and have restructured their foreign trade, they have increasingly directed their trade to the European Union. Recently, the European Union announced that eight countries in Central and Eastern Europe would join the union in 2004, pending the successful conclusion of ongoing negotiations.

Global economic recovery will be lengthy, and the road will be bumpy, well populated, and long. The strength and stability of the U.S. economy will undoubtedly have a tremendous effect on the rest of the world. ■

## PUBLICATIONS AND WEB SITES

The **International Monetary Fund** publishes its *World Economic Outlook* in the spring and fall. It is available at [www.imf.org/external/pubs/ft/weo/2002/02/index.htm](http://www.imf.org/external/pubs/ft/weo/2002/02/index.htm).

The **World Bank** publishes an annual report, *Global Economic Prospects and the Developing Countries*, which focuses on emerging markets and economies in transition. Visit [www.worldbank.org/prospects/gep2003.toc.htm](http://www.worldbank.org/prospects/gep2003.toc.htm).

The **Organization for Economic Cooperation and Development** publishes its *OECD Economic Outlook* every spring and fall. This report focuses on the 30 OECD member countries, most of which are industrial economies. The report is on-line at [www.oecd.org/EN/document/0,,EN-document-0-nodirectorate-no-2-21578-0,00.html](http://www.oecd.org/EN/document/0,,EN-document-0-nodirectorate-no-2-21578-0,00.html).

The **United Nations** publishes its *Global Economic Outlook* annually. See [www.un.org/esa/analysis/link/0402GlobOutlook.pdf](http://www.un.org/esa/analysis/link/0402GlobOutlook.pdf).

The U.N. project research center, **Project LINK**, at the University of Toronto, provides modeling for *Global Economic Outlook*. The Project LINK site contains useful forecasting information as well as links to various organizations and other local and regional reports: [www.chass.utoronto.ca/link/link.html](http://www.chass.utoronto.ca/link/link.html).

Table 2 lists U.S. exports of manufactured goods to the top 20 markets. For additional information on the goods exported to the leading markets as well as other U.S. trading partners, including both import and export data, visit the statistical Web site of the **International Trade Administration**: [www.export.gov/tradestats](http://www.export.gov/tradestats).